

ST 01-19

Tax Type: Sales Tax

Issue: Responsible Corporate Officer – Failure to File or Pay Tax

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
SPRINGFIELD, ILLINOIS**

THE DEPARTMENT OF REVENUE)	Docket #	00-ST-0000
OF THE STATE OF ILLINOIS)	IBT #	
)		
v.)		
)		
JOHN DOE)	Barbara S. Rowe	
Respondent)	Administrative Law Judge	

RECOMMENDATION FOR DISPOSITION

Appearances: Mr. Bruce Thiemann for respondent JOHN DOE; Mr. Charles Hickman, Special Assistant Attorney General for the Illinois Department of Revenue; Mr. John Swartz of Giffin, Winning, Cohen, and Bodewes, P.C. for JOHN SMITH.

Synopsis:

This matter comes on for hearing pursuant to the timely protest by JOHN DOE (hereinafter referred to as the "Respondent" or "DOE") of Notice of Penalty Liability No. 6771 issued on December 31, 1997, by the Illinois Department of Revenue (hereinafter referred to as the "Department"). The notice was issued against DOE as a responsible officer of SMITH-DOE Company, Inc. (hereinafter referred to as "SMITH-DOE" or the "Company") under the Uniform Penalty and Interest Act for the periods of November 1994 and February 1995. The issues to be resolved are: 1) whether the respondent was a responsible officer of SMITH-DOE; 2) whether the respondent's failure to pay the sales tax due was willful; and 3) whether the statute of limitations bars the November 1994 assessment. Upon consideration of the evidence and a careful review of the record, it is recommended that the liability for November 1994 be dismissed and the liability for February 1995 be upheld in its entirety. In support thereof, I make

the following findings and conclusions in accordance with the requirements of Section 100/10-50 of the Administrative Procedure Act (5 ILCS 100/10-50).

Findings of Fact:

1. The *prima facie* case of the Department was established by the admission into evidence of Notice of Penalty No 6771 issued on December 31, 1997, to DOE as a responsible officer of SMITH-DOE. The notice was for sales assessments for the period of November 1994 in the tax amount of \$13,314.88 and February 1995 in the tax amount of \$23,653.43. (Dept. Ex. No. 1; Tr. p. 6)

2. On December 28th 1994¹, the Department received the ST-1 filed by SMITH-DOE for November 1994. The Notice of Penalty Liability was dated December 31, 1997. (Tr. p. 6)

3. SMITH-DOE was in the commercial refrigeration and food services business. The company sold and installed equipment in supermarkets, convenience stores, and restaurants. (Tr. p. 115)

4. DOE was the president of SMITH-DOE during the time period in question. He was also in charge of the sales and engineering aspects of the company. He had the authority to sign checks in behalf of SMITH-DOE during the time periods in question. He in fact signed a number of company checks during that period. (Dept. Ex. No. 2; Tr. pp. 114-115)

5. JOHN SMITH (hereinafter referred to as "SMITH") was the treasurer and office manager of the accounting department of SMITH-DOE. He also had check-signing authority. He prepared and executed the sales tax returns filed by the company. (Dept. Ex. No. 8; Tr. pp. 66-68)

6. Only DOE and SMITH had signature authority on the company's bank accounts. (Tr. pp. 68, 109)

¹ 1994 was not a leap year. The return was Julian dated 94363, which would be the 363rd day of 1994. Counsel for the Department stated that he had no authority to concede the November liability. (Tr. p. 6)

7. Both SMITH and DOE were aware of the financial difficulties of the company. Both determined who would or would not be paid. (Tr. pp. 73-74)

8. SMITH had the responsibility for the day-to-day financial affairs of the company. (Tr. pp. 114, 123)

9. SMITH-DOE had a large monthly cash flow. SMITH would get a monthly-computerized list of checks due. Checks were usually written once a week. The checks were sent when SMITH thought there was sufficient money in the checking accounts to cover the check, usually on a daily basis. Oftentimes checks would be left in his desk drawer for a period of time. DOE knew of the checks in the drawer and would periodically look through them. (Tr. pp. 88-90, 100-104)

10. Regarding the hierarchy of payments made by SMITH-DOE: the first monetary obligation met was payroll; second was FICA and withholding taxes; third and beyond was what was necessary at the time, including sales taxes due the Department. (Tr. pp. 75, 98-101)

11. SMITH-DOE was assigned to a collection officer with the Department on July 21, 1992, due to the taxes owed. Regarding the taxes due, the collection officer dealt exclusively with SMITH from July 21, 1993 through May 2, 1994. For the subsequent period, another collection officer was assigned to SMITH-DOE. That officer also discussed with SMITH the debt owed to the Department. SMITH was introduced as the controller of the company. (Dept. Ex. No. 3; Tr. pp. 8-11, 16-19, 37-43)

12. SMITH as treasurer of SMITH-DOE executed an installment contract with the Department on March 12, 1992. The contract stated that SMITH submitted a down payment of \$9,653.36 toward the liability of \$58,301.11 and agreed to make monthly payments. SMITH name is listed at the top of the document. (DOE Ex. No. 1; Tr. pp. 27-28, 91-92)

13. SMITH executed a second installment contract with the Department on January 14, 1994. The contract stated that SMITH had submitted a down payment of \$20,050.00 and agreed to make weekly payments toward the liability of \$92,448.00. SMITH negotiated the contract, but insisted that DOE would be the responsible corporate officer for the debt. DOE's

name and address are listed at the top of the contract, but DOE was not present when the contract was negotiated and signed. DOE never gave permission for his name to be listed on the document. (Dept. Ex. No. 5; Tr. pp. 14-15, 19-21, 26-27)

14. On February 7, 1994, the Department sent DOE a letter indicating he had entered into a pay agreement with the Department and identifying what would cause a default of the agreement. (Dept. Ex. No. 6; Tr. pp. 30-31)

15. There is no evidence that DOE objected to the pay agreement that listed him as the responsible corporate officer.

16. DOE was a director of SMITH-DOE. (Tr. p. 106)

17. DOE was the sole-shareholder of SMITH-DOE. (Tr. pp. 106-107)

18. DOE had the authority to fire SMITH. (Tr. p. 109)

19. DOE had access to corporate records at all times. (Tr. p. 111)

20. DOE signed promissory notes on behalf of SMITH-DOE. (Tr. p. 110)

21. DOE guaranteed corporate debts for the company. (Tr. pp. 110-111)

22. In his capacity as president, DOE acknowledged the receipt of a ten-day Notice of Intent to Seize Assets dated December 15, 1994, in the amount of \$63,551.00 for Retailers' Occupation Tax liabilities and income tax withholding liabilities. The notice was served on both DOE and SMITH on December 16, 1994. This was the first time that the collection officer met DOE. (Dept. Ex. No. 4; Tr. pp. 11-14, 17, 82)

23. Upon receiving the ten-day Notice of Intent to Seize Assets on December 16, 1994, DOE understood he had a significant liability with the Department. (Dept. Ex. No. 4; Tr. p. 110)

24. On March 10, 1995, DOE, as president of SMITH-DOE, executed an assignment that transferred all the property of the company to Michael Scorokas as trustee-assignee for the benefit of all the creditors of SMITH-DOE. The document showing the action by the Board of Directors granting unanimous consent to the assignment was also executed by DOE on March 10, 1995. The document showing the action by the shareholders granting unanimous written

consent to the assignment was also signed solely by DOE. The affidavit accompanying the documents states that the notary public certified that DOE signed the instrument as his free and voluntary act and is the sole shareholder of the company. The assignment was accepted. (Dept. Ex. No. 7; Tr. pp. 109-110)

25. The Department attempted to seize the assets of SMITH-DOE. On March 15, 1995, at 9:30 a.m. the warrant was executed. The warrant was served on personnel of the company. Both DOE and SMITH were present. At that time, the Department was notified of the assignment for the benefit of creditors. The Department notified the Attorney General's Office and was instructed to retract the warrant and allow SMITH-DOE to proceed with the assignment. The checklist for seizure and seizure warrant did not reflect amounts due for sales that occurred in February 1995. (DOE Ex. Nos. 2 & 3; Tr. pp. 32-35, 43-45)

26. The First of America check register for checking account 102800 in the name of SMITH-DOE for November 1994 shows checks written to various entities in the amount of \$327,445.73. If the company had chosen to pay its sales tax liability rather than other creditors, sufficient funds were available for the payment. (Dept. Ex. Nos. 11 & 12; Tr. pp. 77-80)

27. The First of America check register for checking account 102800 in the name of the company for February 1995 shows checks issued to various entities in the amount of \$172,789.26. Sufficient funds were available to SMITH-DOE to pay the liability owed the Department of Revenue for the sales tax due for that month. (Dept. Ex. No. 12; Tr. p. 81)

28. DOE, in his capacity as president of SMITH-DOE, signed various Uniform Commercial Code financing statements, indicating SMITH-DOE as debtor and filed these with the Illinois Secretary of State's office. (Dept. Ex. No. 13; Tr. p. 111)

29. The non-check activity statement sent to SMITH-DOE from First of America Bank dated November 30, 1994 shows numerous overdraft charges for the company. The statement reflects that the bank required additional funds of \$55,942.25 to offset the service charges. (Dept. Ex. No. 14)

30. The non-check activity statement from First of America Bank sent to SMITH-DOE dated February 28, 1995 also shows numerous overdraft charges for the company. The statement reflects that the bank required additional funds of \$42,118.56 to offset the service charges. (Dept. Ex. No. 15)

31. DOE did not direct SMITH not to pay the liabilities owed to the Department. He did direct SMITH to pay other creditors. (Tr. pp. 75, 93-97, 116)

32. DOE was aware that the Department was a creditor of SMITH-DOE and that sales taxes were required to be paid. He was also aware that SMITH and the Department had negotiated payment agreements. (Tr. pp. 116-119)

33. In early 1994, SMITH informed DOE that the company was in trouble with the IRS as well as with the Department. DOE worked out a payment plan with the IRS and paid them about \$1,000.00 per week. (Tr. p. 120)

Conclusions of Law:

I address the issues presented out of order as follows:

As to the statutory limitations period for issuing the notice at issue, the pertinent statute states:

(c) The personal liability imposed by this Section shall survive the dissolution of a partnership, limited liability company, or corporation. No notice of penalty liability shall be issued after the expiration of 3 years after the date all proceedings in court for the review of any final or revised final assessments issued against a taxpayer which constitute the basis of such penalty liability have terminated or the time for the taking thereof has expired without such proceeding being instituted or after the expiration of 3 years after the date a return is filed with the Department by a taxpayer in cases where the return constitutes the basis of such liability. 35 ILCS 735/3-7(c)

On December 28, 1994, the Department received the ST-1 filed by SMITH-DOE for November 1994. The Notice of Penalty Liability was dated December 31, 1997. Clearly the date of issuance of the Penalty Liability with regard to the filing date of the November ST-1 return is

untimely. The November return formed the basis of the liability. It is therefore recommended that the liability for November 1994 be dismissed.

The Department seeks to impose personal liability on DOE for February 1995 pursuant to Section 3-7 of the Uniform Penalty and Interest Act. The act reads in pertinent part:

Any officer or employee of any taxpayer subject to the provisions of a tax Act administered by the Department who has the control, supervision or responsibility of filing returns and making payment of the amount of any trust tax imposed in accordance with that Act and who willfully fails to file the return or make the payment to the Department or willfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the taxpayer including interest and penalties thereon. The Department shall determine a penalty due under this Section according to its best judgment and information, and that determination shall be prima facie correct and be prima facie evidence of a penalty due under this section. * * * 35 ILCS 735/3-7(a)

An officer or employee of a corporation may therefore be personally liable for the corporation's taxes if (1) the individual had the control, supervision, or responsibility of filing the returns and paying the taxes, and (2) the individual willfully failed to perform these duties.

In determining whether an individual is a responsible person the courts have indicated that the focus should be on whether that person has significant control over the business affairs of a corporation and whether he or she participates in decisions regarding the payment of creditors and disbursement of funds. Monday v. United States, 421 F.2d 1210 (7th Cir. 1970), *cert. denied* 400 U.S. 821 (1970). Liability attached to those with the power and responsibility within the corporate structure for seeing that the taxes are remitted to the Government. *Id.*

The Department's certified record relating to the penalty liability constitutes *prima facie* proof of the correctness of the penalty due.² Branson v. Department of Revenue, 168 Ill.2d 247,

² The relevant portion of §3-7 states:

Proof of that determination by the Department shall be made at any hearing before it or any legal proceeding by reproduced copy or computer printout of the Department's record relating thereto in the name of the Department under the certificate of the Director of Revenue. * * * That certified reproduced copy or certified computer print-out shall without further proof, be admitted into evidence before the Department or in any legal proceeding and shall be prima facie proof of the correctness of the amount of tax or penalty due. 35 ILCS 735/3-7.

260 (1995). Once the Department presents its *prima facie* case, the burden shifts to the respondent to establish that one or more of the elements of the penalty are lacking, i.e., that the person charged was not the responsible corporate officer or employee, or that the person's actions were not willful. *Id.* at 261. In order to overcome the Department's *prima facie* case, the allegedly responsible person must present more than his or her testimony denying the accuracy of the Department's assessment. A. R. Barnes & Co. v. Department of Revenue, 173 Ill.App.3d 826, 833-34 (1st Dist. 1988). The person must present evidence that is consistent, probable, and identified with the taxpayer's books and records to support the claim. *Id.*

In this case the Department's *prima facie* case was established when the Department's certified record relating to the penalty liability was admitted into evidence. Once the Department established its *prima facie* case, the burden shifts to the taxpayer to overcome that burden.

The respondent relies upon In re Stoecker, 202 B.R. 429 (Bkr. N.D. Ill. 1998) for its interpretation of willfulness. Stoecker states that the mere status as a corporate officer is insufficient to create personal liability as a responsible officer under the willfulness standard. The court held that non-payment of tax must result from a voluntary, conscience, and intentional failure to pay by the allegedly responsible person.

For guidance in determining the meaning of "willful", the Illinois Supreme Court has referred to cases interpreting Section 6672 of the Internal Revenue Code (26 U.S.C. §6672).³ Branson at 254-55; Department of Revenue v. Heartland Investments, Inc., 106 Ill.2d 19, 29-30 (1985). These cases define willful as involving intentional, knowing, and voluntary acts or alternately, reckless disregard for obvious known risks. *Id.* Willful conduct does not require bad purpose or intent to defraud the government. Branson at 255; Heartland at 30. Willfulness may be established by showing that the responsible person (1) clearly ought to have known that (2) there was a grave risk that the taxes were not being paid and (3) the person was in a position to find out for certain very easily. Wright v. United States, 809 F.2d 425, 427 (7th Cir. 1987).

³ This section imposes personal liability on corporate officers who willfully fail to collect, account for, or pay over employees' social security or Federal income withholding taxes.

Furthermore, whether the person in question willfully failed to pay the taxes is an issue of fact to be determined on the basis of the evidence in each particular case. Heartland at 30; Department of Revenue v. Joseph Bublick & Sons, Inc., 68 Ill.2d 568, 577 (1977).

In dispensing with the statute of limitations issue, the only time period and amount in controversy is for February 1995. DOE was the president and sole shareholder of the company. He was in charge of the sales and engineering aspects of the company. While SMITH was admittedly the person responsible for the day-to-day financial affairs of the company, DOE had the authority to sign checks in behalf of the company, and did so. DOE and SMITH met frequently to discuss the finances of the company. DOE was aware of the liabilities due the Department. The actions of DOE that compel me to find that he was a responsible officer in regards to the debt due for February 1995 were his actions from December 16, 1994 through March 10, 1995.

DOE was served with the Department's ten-day notice of intent to seize assets on December 16, 1994. He understood at that time that the company had a significant tax liability with the Department. The February 1995 sales tax return was due to the Department on March 20, 1995. On March 10, 1995, DOE executed the assignment that transferred all the property of the company. By that action, he exhibited **control over any and all** aspects of the company. This action took place right before the return at issue should have been filed with the Department.

Therefore, in the present case DOE did not provide any evidence to indicate that the failure to pay the taxes was not willful. In fact, the assignment which stopped the Department's seizure action was an acknowledgment of the debt and an affirmative action to avoid it. DOE had access to the company's books and records, and he knew that the company was having financial difficulties. Moreover, DOE admitted that he had access to the company's funds, and he made certain that liabilities to suppliers and the payroll were paid. Courts have found that giving preferential treatment to other creditors rather than paying the corporation's taxes constitutes willful behavior. Heartland at 29-30. DOE has therefore failed to show that his

actions were not willful and in fact has established that he was able to perform a personal willful action in an attempt to avoid the debt due.

There is nothing in the record to indicate that the notice of penalty liability at issue was untimely regarding the responsibility of DOE for February 1995. It is recommended that the liability for February 1995 in the tax amount of \$23,653.43 be upheld in its entirety.

Respectfully Submitted:

Barbara S. Rowe
Administrative Law Judge

Date: September 5, 2001